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In the Supreme Court of the United States

OCTOBER TERM, 1948

No. 288

LEWIS L. STRAUSS, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 17-33) and the dissenting opinions (R. 33-37) are reported at 8 T.C. 1058. The opinion of the Court of Appeals (R. 62-69) is reported at 168 F. 2d 441.

JURISDICTION

The judgment of the Court of Appeals was entered on June 4, 1948 (R. 69-70). A petition for rehearing (R. 71-74) was denied on June 22,

1948 (R. 75-76). The petition for a writ of certiorari was filed on September 20, 1948. The jurisdiction of this Court is invoked under 28 U. S. C., Sec. 1254.

QUESTION PRESENTED

As compensation for services rendered the taxpayer acquired an "interest" in the Kodachrome process of manufacturing color film, which interest consisted only of the right to receive a percentage of the future royalties paid on the process. The question is whether the assignment by taxpayer to his wife in 1935 of his "interest" in the process operated to relieve him of liability for income tax on the royalties paid to his wife in the taxable years 1938 and 1939 pursuant to the assignment.

STATUTES INVOLVED

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * *

Section 22 (a) of the Internal Revenue Code (26 U. S. C. 22), which applies to the year 1939, is substantially the same.

STATEMENT

The facts were stipulated (R. 39-41) and were found by the Tax Court as stipulated (R. 18). The facts with respect to the issue presented in the petition for certiorari,[1] as stated by the Tax Court (R. 18-20), are substantially as follows:

By written assignment dated November 1, 1930, Leopold D. Mannes and Leopold Godowsky, Jr., the inventors of a process known as "Kodachrome", used in the manufacture of colored film, had assigned to Kuhn, Loeb & Company as trustees all the royalties payable by the Eastman Kodak Company to them under a license agreement and an option agreement of the same date,[2] except certain flat royalties payable directly to them as the inventors and which are not here in question. Thereafter the trustees paid the royalties to those entitled to receive them. (R. 18-19.)

Prior to 1935 the taxpayer rendered certain services to the New York and Foreign Development Corporation, a corporation formerly existing under

[1] The Court of Appeals decided a question with respect to the taxpayer's cost basis of common stock of Polaroid Corporation for purposes of determining the gain on the sale of such stock in 1938 (R. 64-69), but this holding is not involved in the petition for certiorari.

[2] The license and option agreements between them and Eastman Kodak Company were not annexed to the copy of their assignment, introduced in evidence in the Tax Court as Exhibit 3C of the Stipulation of Facts.

the laws of the State of New York, in connection with the financing of the Kodachrome process. For the rendition of the services, the taxpayer became entitled to receive a certain percentage of the royalties on the process. (R. 18.)

It was alleged in the petition and admitted in the answer in the Tax Court that "In 1935 the petitioner was the owner of an interest in the Kodachrome process of manufacturing color film". (R. 19.)

On December 20, 1935, the taxpayer delivered a letter to his wife, stating that he had, that day, assigned and transferred to her as a gift absolutely and irrevocably all his "right, title and interest in Kodachrome, manufactured by the Eastman Kodak Company." On December 20, 1935, he notified the trustees in writing of the assignment of royalties to his wife. (R. 19-20.)

During 1938 taxpayer's wife received from the trustees, pursuant to the assignment, $10,209.50 in royalties paid upon the Kodachrome process and during 1939 she received $14,183.94 in such royalties. All these royalties were paid for periods beginning after 1935. Taxpayer's wife included these amounts in her federal income tax returns for the years 1938 and 1939, respectively, and paid income tax thereon. She has timely filed protective claims for refund for those years in view of the Commissioner's position that the royalties are properly taxable to taxpayer. (R. 20.)

In determining the deficiencies here involved the Commissioner included the amounts of the royalties in taxpayer's income for the respective taxable years, explaining that such income "was received in payment for services rendered" by taxpayer. (R. 20.)

The Tax Court reversed this determination and held that the royalties paid to his wife in the taxable years were not taxpayer's income. (R. 27-31.) Judges Harron and Opper filed dissenting opinions (R. 33-37) and Judge Turner noted a general dissent (R. 33).

The Court of Appeals reversed the Tax Court. (R. 62-64.)

ARGUMENT

(1) Contrary to taxpayer's contention (Pet. 6; Br. 9-12), the Court of Appeals did not reject the so-called "finding" of the Tax Court that the taxpayer owned and assigned to his wife his "interest" in the Kodachrome process. It simply regarded the label attached by the Tax Court as not determinative and ascertained the real nature of what was assigned.[3] (R. 63-64.) This was the correct approach since the assignment of "property" does

[3] In contrast, the majority of the Tax Court did not deem it necessary to look beyond the label. (R. 28-31.) Compare the two dissenting opinions. (R. 33-37.) It is noted that, although the Commissioner's answer admitted that in 1935 the taxpayer owned an interest in the Kodachrome process (R. 6, 15), the pleadings did not define what rights this interest gave him. Moreover, the answer denied that taxpayer assigned his interest to his wife as alleged in paragraph (b) of the petition. (R. 6.)

not of itself determine that the income will not be taxable to the assignor. Indeed, the right to receive future income is a property right, but the assignment of such a property interest does not avoid the tax on the income. See *Helvering* v. *Horst,* 311 U. S. 112, 115, in which the Court expressly noted that a property right, the right to receive interim payments of interest, had there been transferred; *Helvering* v. *Eubank,* 311 U. S. 122; *Harrison* v. *Schaffner,* 312 U. S. 579, 582.[4]

The stipulated facts, which the Tax Court found as stipulated (R. 18), fully sustain the statements of the Court of Appeals (R. 63-64) that the taxpayer's interest consisted of only the right to receive a percentage of the royalties as they became payable, and that he did not receive any part of the Kodachrome process itself or any right to control its disposition. The stipulation shows that for financing services rendered in connection with the Kodachrome process prior to 1935, taxpayer became entitled "to receive a certain percentage of

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[4] Nor is the assignment of a property right determinative of the issue where the donor's retained rights or powers are such that he should be treated as in substance the owner of the property or the income. *Helvering* v. *Clifford,* 309 U. S. 331; *Commissioner* v. *Sunnen,* 333 U. S. 591. Moreover, where "property" which would constitute income to the assignor as it is *pro tanto* liquidated by payment is assigned, the assignor remains taxable on the payments received by the assignee. *Commissioner* v. *First State Bank,* 168 F. 2d 1004 (C.C.A. 5th), pending on petition for writ of certiorari, No. 285, this Term; *Richards' Estate* v. *Commissioner,* 150 F. 2d 837 (C.C.A. 2d); *Doyle* v. *Commissioner,* 147 F. 2d 769 (C.C.A. 4th).

the royalties" on the process.[5] (R. 40.) In 1935 he assigned to his wife "the right to receive the royalties" as the stipulation states (R. 40), in a letter which in terms assigned his "interest" in Kodachrome (R. 20). On the same date taxpayer notified Kuhn, Loeb and Company, the trustees, who in 1930 had received from the inventors of the process an assignment of *the royalties payable* under the license granted to Eastman Kodak Company, of his assignment of royalties to his wife. (R. 40.) It is thus clear that the right to receive a percentage of the royalties distributable under the trust arrangement with Kuhn, Loeb and Company, which itself had no rights in the process other than to receive royalties, was the measure of taxpayer's interest in the process and that this right only was what was assigned to his wife. In this connection it is significant that the Tax Court did not find that the taxpayer had any rights in, or control over, the process, other than the right to share in the future royalties.

The taxpayer now suggests (Br. 13) that if the nature of his interest in the process were regarded as relevant, the Court of Appeals should have remanded the case to the Tax Court for findings on the point. This contention ignores the fact that the

[5] Since taxpayer had the right to receive only a *percentage* of the royalties payable on the process, there is no merit to the taxpayer's argument (Br. 12) that on the record he was the *only person* who had an interest in the process. The royalties in excess of taxpayer's percentage necessarily were payable to, or were owned by, another or others.

Tax Court found the facts as stipulated and that the stipulated facts show that taxpayer's interest consisted only of the right to receive royalties. The stipulation is plainly conclusive upon the taxpayer, who as the moving party had the burden to show of what his interest in the process consisted. Neither *Helvering* v. *Taylor,* 293 U.S. 507, nor *Helvering* v. *Rankin,* 295 U.S. 123, is pertinent here, since the Commissioner did not make an arbitrary and excessive determination of a deficiency and the Court of Appeals did not substitute a finding of its own in place of the stipulated facts which were adopted by the Tax Court.

(2) The Court of Appeals decided this case in accordance with the controlling decisions of this Court. The rule has long been clear that under Section 22(a) of the Revenue Act of 1938 and the Internal Revenue Code, *supra,* which defines gross income as including income derived from compensation for personal service of whatever kind and in whatever form paid, personal earnings are taxable to the one who earns them; in the case of earnings the services produce the income and in consequence the tax cannot be deflected to another by means of any kind of anticipatory arrangement, even though the assignment purports to transfer a "property interest". *Lucas* v. *Earl,* 281 U.S. 111; *Burnet* v. *Leininger,* 285 U.S. 136; *Helvering* v. *Eubank,* 311 U.S. 122; *Commissioner* v. *Harmon,* 323 U.S. 44, rehearing denied, 323 U.S. 817; *Commissioner*

v. *Tower,* 327 U.S. 280, 289. See also *Helvering* v. *Horst,* 311 U.S. 112, 119; *Blair* v. *Commissioner,* 300 U.S. 5, 11; *Commissioner* v. *Sunnen,* 333 U.S. 591, 604; Paul, Federal Estate and Gift Taxation (1946 Supp.), Sec. 16.12, pp. 702-704. The decision of the Court of Appeals correctly applied that rule here.

This case is in all material respects similar to *Helvering* v. *Eubank, supra,* as the Court of Appeals held. (R. 64.) There in one instance Eubank assigned *all of his interest in a contract* under which he was entitled to receive, for his former services as agent, renewal commissions on insurance policies originally written by him. Despite the formal transfer of his property interest in the contract, this Court treated it, like the other assignment there involved, as in substance a transfer of the right to receive income, pointing out that the only purpose appeared to be to confer on the assignees the power to collect the commissions. So in the present case the taxpayer's assignment of his right to receive future royalties, acquired as compensation for personal services rendered in the past (see Stip., par. 2, R. 40), although referred to as an "interest" in Kodachrome, was in point of substance a transfer only of the right to receive personal earnings payable in the future, on which he remains taxable. Here, as in the *Eubank* case, the obvious purpose of the assignment was to confer

upon his wife the right to receive the future royalties.

The present case is not outside the scope of the *Eubank* case, as taxpayer argues (Br. 15-18), because the royalties were paid by a third person rather than by the taxpayer's employer. The taxpayer derived his right to receive the royalties from his employer as compensation for services, as stipulated (R. 40), and the royalties represented his earnings regardless of who actually paid them. Nor is the *Eubank* case distinguishable on the technical ground that taxpayer's compensation consisted of the acquisition of a property interest in the process rather than of the royalties themselves. Although the majority of the Tax Court took this view (R. 31), the stipulation which the Tax Court adopted (R. 18) stated plainly (R. 40) that the right to receive future royalties was the compensation for taxpayer's services. Moreover, taxpayer did not show that his interest in Kodachrome conferred upon him any right which would remunerate him, apart from the royalties he would receive. Quite obviously the parties contemplated that the taxpayer would derive his compensation from the future royalties he was entitled to receive, in lieu of direct payments by his employer. Cf. *Commissioner* v. *Smith,* 324 U.S. 177, rehearing denied, 324 U.S. 695. As *Helvering* v. *Horst,* 311 U.S. 112, 115-118, explains, a taxpayer on the cash receipts basis, who acquires a right to receive in-

come, is not taxed at the time his right to receive accrued, but instead is taxed when he receives the income or when it is paid to his donee pursuant to his previous assignment. Cf. *Perry* v. *Commissioner*, 152 F. 2d 183 (C.C.A. 8th).

Taxpayer's assertion (Pet. 7; Br. 18) that the judgment in this case conflicts with *Blair* v. *Commissioner*, 300 U.S. 5 is incorrect. That case did not involve the assignment of the right to receive recurring payments which represented compensation for personal services.[6] The *Blair* opinion specifically pointed out (p. 11)—"The tax here is not upon earnings which are taxed to the one who earns them." For the same reason there is no conflict with *Nelson* v. *Ferguson*, 56 F. 2d 121 (C.C.A. 3d), certiorari denied, 286 U. S. 565 (see Pet. 7; Br. 14); the right to receive royalties there did not represent compensation.[7]

(3) The taxpayer's contention (Pet. 7; Br. 19) that the decision of the Court of Appeals leaves the

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[6] This is not to say that the taxpayer in this case would escape the tax if his right to receive royalties had not been received as compensation for services. *Harrison* v. *Schaffner*, 312 U.S. 579, which limits the scope of the *Blair* case, indicates (p. 582) that even where the income is not personal earnings an assignor does not avoid the tax by attempting to disguise the transaction as a transfer of property rather than a transfer of income where that is its obvious purpose and effect.

[7] In the *Nelson* case the taxpayer transferred (without right to sell) to his employer a patent for exploitation in consideration of the payment of royalties, reserving the power to terminate the contract and reacquire the patent if the royalties fell below a certain amount or if the employer discontinued his employment. Nelson assigned the right to receive the royalties to his wife. Taking into consideration what was

position of persons who assign the right to receive payments constituting compensation in doubt is unwarranted. On the contrary the decisions of this Court, previously cited, established the rule that one who personally earns income is taxable on his earnings even though they have been assigned in advance of payment to another. Because of these decisions, the question in this case can hardly be described as unsettled. Nor does the decision have a "drastic effect" (Br. 19) because the earner cannot himself receive or obtain the income after it has been assigned. That has been true in most of the cases decided by this Court. But cf. *Commissioner* v. *Sunnen,* 333 U.S. 591. As *Helvering* v. *Horst,* 311 U.S. 112, 116-117, explains, the taxpayer who assigns income in advance of its payment has realized and enjoyed the income by exercising his power to procure its payment to another, equally as if he had collected it himself. See also *Harrison* v. *Schaffner,* 312 U. S. 579, 582.

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assigned and the rights reserved by Nelson, we believe the decision is unsound in the light of subsequent decisions by this Court. *Helvering* v. *Horst, supra; Harrison v. Schaffner, supra; Commissioner* v. *Sunnen,* 333 U.S. 591.

CONCLUSION

The judgment below is correct under controlling decisions of this Court and does not conflict with any decision. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted,

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